

NEW APPLICATION



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BEFORE THE ARIZONA CORPORATION COMM

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ORIGINAL

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AZ CORP COMMISSION
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T-03267A-05-0731

In the Matter of the Application of **McLeodUSA**)
Telecommunications Services, Inc. For Expedited)
Approval to Encumber Assets and Issue a)
Guarantee in Connection With Certain Financing)
Arrangements)
_____)

DOCKET NO. T-03276A-05-_____

APPLICATION

(EXPEDITED CONSIDERATION REQUESTED)

McLeodUSA Telecommunications Services, Inc. ("McLeodUSA" or "Applicant"), through undersigned counsel and pursuant to Section 40-285 of the Arizona Revised Statutes, Ariz. Rev. Stat. § 40-285 and R14-2-804.B.1 of the Arizona Administrative Code, hereby requests that the Commission grant such authority as may be necessary or required to permit Applicant to consummate a consensual (i.e. "pre-packaged") Chapter 11 financial restructuring ("Restructuring") in the bankruptcy court. The Chapter 11 filing will: (i) extinguish the equity interest of the current shareholders in McLeodUSA's ultimate parent company, McLeodUSA Incorporated ("Parent", together with McLeodUSA, "Parties") and (ii) extinguish the existing debt, presently secured/guaranteed by Applicant, and convert certain secured creditors to shareholders of Parent. By extinguishing existing debt, the Parties will become financially stronger.

This purely financial Restructuring, will not change the overall business organization of the Parties. Applicant will continue to be wholly-owned by Parent. The Parent's management team will remain intact. None of the new shareholders of the Parent will have a controlling interest in the Parent. Therefore, no new holding company will be created. The existing structure of McLeodUSA's parents will remain unchanged. An organizational chart demonstrating this attached as Exhibit A. Thus, McLeodUSA submits that Commission Rule R14-2-803 does not apply.¹

Most importantly, the prepackaged Chapter 11 filing provides certainty to existing McLeodUSA customers with respect to their telecommunications service. It will enable McLeodUSA's current operations to continue without interruption or any changes to the rates, terms and conditions of the services that its customers currently receive. To the extent that McLeodUSA has deposits or prepayments from its Arizona customers, those deposits and prepayments will not be affected. The Chapter 11 filing also will not affect in any way the \$600,000 performance bond already in place in Arizona to ensure the continuity of McLeodUSA's service. See Decision No. 64657 (March 25, 2002).

Because of the consensual nature of the Restructuring, the Chapter 11 proceedings will take place on an expedited basis and are expected to conclude by November 28, 2005. In light of the current financial position of the Parties, the purely financial nature of the Restructuring, and the expedited Bankruptcy Court schedule, Applicant respectfully requests that the Commission approve

¹ Under Decision No. 58063 (at 6) (the Public Utility Holding Companies and Affiliated Interests Rules Stay Lifting Order), the Commission held that Rule 803.A would not be imposed if the reorganization of the public utility holding company did not change the structure of the business organization. McLeodUSA submits that given the nature of this financial reorganization, Rule 803.A is not implicated. However, in a effort to expedite the processing of this application, McLeodUSA is

this Application expeditiously in order to grant the authority requested herein prior to, but no later than, November 28, 2005.

In support of this Application, Applicant states as follows:

I. Description of McLeodUSA Telecommunications Services, Inc. ("McLeodUSA")

McLeodUSA is an Iowa corporation with principal offices located at McLeodUSA Technology Park, 6400 C Street, SW, Cedar Rapids, Iowa 52406-3177. McLeodUSA provides integrated communications services, including local services, primarily in 25 Midwest, Southwest, Northwest, and Rocky Mountain states. McLeodUSA is a wholly owned subsidiary of McLeodUSA Holdings, Inc. which, in turn, is a wholly owned subsidiary of Parent.

In Arizona, McLeodUSA is authorized to provide competitive resold and facilities-based local exchange and interexchange telecommunications service pursuant to Certificates of Convenience and Necessity granted by the Commission in Decision Nos. 61001 and 62627.

In Arizona, McLeodUSA, provides service to almost 4000 business customers and almost 1000 residential customers, primarily in the Phoenix and Tucson markets. McLeodUSA has invested in facilities in Arizona, including a switch and a fiber network. McLeodUSA's presence in Arizona provides increased choice and competition in Arizona, which benefits the Arizona consumers.

Further information concerning McLeodUSA's legal, technical, managerial and financial qualifications to provide service was submitted with its applications for certification with the Commission as noted above and is, therefore, a matter of public record. McLeodUSA

providing information pertinent to Commission review under Rule 803.A in the event that the Commission concludes the Rule 803 applies.

respectfully requests that the Commission take official notice of that information and incorporate it herein by reference.

II. Contact Information

Questions or inquiries concerning this Application should be directed to:

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III. Description of the Chapter 11 Plan of Reorganization

The financial Restructuring is part of a bankruptcy plan of reorganization (the "Plan") under Chapter 11 of the United States Bankruptcy Code, 11 U.S.C. § 101-1330, that has been agreed upon by Parent and a majority of its secured creditors. Parent is currently soliciting its creditors' votes on the Plan consistent with the Bankruptcy Code, and intends to file the Plan with the United States Bankruptcy Court for the Northern District of Illinois (the "Bankruptcy Court") upon completion of the solicitation process, thereby commencing the Chapter 11 proceedings.

This “pre-packaged” Plan will enable McLeodUSA to continue current operations without interruption or any change in the rates, terms or conditions of the services that its customers currently receive.² The consensual Plan will protect unsecured creditors and enable the Parties to emerge from Chapter 11 as soon as possible. Given the consensual nature of the Plan, the Chapter 11 proceedings will take place on a very expedited basis. The expedited process also provides a level of comfort and certainty to existing McLeodUSA customers because it ensures that McLeodUSA will be able to continue to provide telecommunications service without protracted legal proceedings. The Parties anticipate that they will commence these cases on or about October 28, 2005, and, as noted above, that they will request that the Bankruptcy Court consider and approve the Plan no later than November 28, 2005. Accordingly, it is important that the Applicant obtain the necessary regulatory approval for the Restructuring prior to, but no later than, such date.

Also as noted above, the proposed Restructuring is purely financial in nature, and will not alter the terms, conditions or services offered by McLeodUSA in Arizona. Pursuant to the consensual Plan, debt owed to certain secured creditors will be extinguished and those creditors will become the shareholders of Parent. Therefore, \$750 Million in debt, which was secured by encumbrances on McLeodUSA’s assets (and related guarantees), as authorized by Decision No. 64657, will be eliminated. In addition, the current shareholders’ existing equity in Parent will be

² As part of the Restructuring, Parent and its wholly owned subsidiaries will each act as a debtor-in-possession (“DIP”) in the Chapter 11 proceeding and a DIP credit facility in the amount of \$50 million will be issued for working capital and general corporate purposes in accordance with approved budgets to assure that operations continue on an uninterrupted basis during the Restructuring. As with the existing credit facility, all of Parent’s wholly owned subsidiaries, including McLeodUSA, will act as guarantors and pledge all or substantially all of their assets to secure the DIP credit facility. This credit facility and the associated security interests will be refinanced with the proceeds of the exit facility described elsewhere in this application upon consummation of the Restructuring.

extinguished.³ However, the corporate structural organization will remain the same and direct ownership of McLeodUSA will not change.

Although the precise equity ownership of Parent will not be known until the Company emerges, the new shareholders will be major institutional investment companies, and Applicant does not expect that any single entity or group of entities will hold working or actual control over Parent and, thereby, no entity will have indirect control over McLeodUSA. Specifically, the following entities will be the six largest equity holders in Parent and therefore are anticipated to be the five largest indirect owners of McLeodUSA following the Restructuring:

Fidelity Investments (approximately 31%)
Wayzata Investment Partners LLC (approximately 15%)
Credit Suisse First Boston, Zurich (approximately 6%)
Odyssey Credit Investors (approximately 6%)
Secondary Loan & Distressed Credit Trading (approximately 5%)

McLeodUSA currently guarantees, and has pledged all or substantially all of its assets, to secure Parent's obligations under its existing credit facilities. As of September 1, 2005, obligations outstanding under the Senior Prepetition Credit Agreement totaled approximately \$100 million plus \$7.4 million in unfunded letters of credit. The obligations under the senior credit agreement will convert to "New Term Loan Notes" pursuant to the Plan. As of September 1, 2005, obligations outstanding under the Junior Prepetition Credit Agreement totaled approximately \$677.3 million plus accrued and unpaid interest. The obligations under the Junior Prepetition Credit Agreement will be converted into equity pursuant to the Plan. Thus, the total

³ Under the Plan, all equity interests in Parent will be extinguished, including the 58% majority share of the equity interest in Parent currently held by various partnerships and investment funds controlled or managed by Forstmann Little & Co.

debt currently guaranteed by McLeodUSA's pledge of all or substantially all of its assets is, as of September 1, 2005, approximately \$785 million plus accrued and unpaid interest.

As part of the Restructuring, McLeodUSA will enter into a new post-bankruptcy "exit" credit facility which will provide for a secured, revolving credit facility in an amount not exceeding \$50 million, with a letter of credit sub facility in an amount not exceeding \$15 million. The exit facility credit agreement will also govern the New Term Loan Notes described above. The exit facility will provide the Parties with the financing necessary to provide liquidity for operational and working capital to allow them to emerge from the Restructuring as a financially stronger operation. After the Restructuring, the total debt guaranteed by McLeodUSA's pledge of all or substantially all of its assets will be approximately \$150 million plus accrued and unpaid interest.

McLeodUSA will pledge all or substantially all of its assets to secure Parent's obligations under the exit facility credit agreement. This pledge will replace the pledge that currently secures Parent's obligations under the Senior Prepetition Credit Agreement and Junior Prepetition Credit Agreement. Accordingly, the Parties request that the Commission approve the guarantee and pledge by McLeodUSA of all or substantially all of its assets to secure Parent's obligations under the exit facility credit agreement.

Following the Restructuring, McLeodUSA's customers will continue to receive service under the same rates, terms and conditions of service today. Neither the bankruptcy reorganization at the Parent level nor the encumbrances and guarantees with respect to the new revolving credit facility will require McLeodUSA to increase its maximum rates for telecommunications services in Arizona. McLeodUSA will remain a wholly owned indirect subsidiary of Parent, will continue to operate and provide services to McLeodUSA's customers,

and will retain the assets used in the provisions of those services. Importantly, McLeodUSA's existing \$600,000 performance bond will remain in place and will be unaffected by the Chapter 11 proceeding. In sum, the proposed Chapter 11 Plan and post-bankruptcy credit facility will not involve any change in McLeodUSA's operations in Arizona and will be completely transparent to McLeodUSA's customers. Finally, as of September 29, 2005, McLeodUSA held approximately \$53,000 in deposits and prepayments from Arizona customers. The Plan will not affect those funds in any way.

IV. Information Related to A.A.C. R14-2-803

As noted above, the bankruptcy plan of reorganization does not create a new public utility holding company. Nor does the overall corporate organizational structure change. Rather certain shareholder equity in Parent is extinguished and certain secured lenders become shareholders in Parent. No single shareholder gains control over Parent. McLeodUSA submits the following information, as requested by Rule 803.A, in the event that the Commission determines that Rule 803, as clarified by Decision No. 58063, is implicated by the bankruptcy plan of reorganization.

1. *The names and business addresses of the proposed officers and directors of the holding company;*

The officers and directors of Parent and McLeodUSA will remain the same through the confirmation of the Plan. McLeodUSA's Officers and Director are:

Chris A. Davis	Chairman and Sole Director
Stanford Springel	Chief Restructuring Officer
Joseph H. Ceryanec	Acting Chief Financial Officer, Group Vice President, Treasurer and Controller
Andreas C. Papanicolaou	Executive Vice President
Roy C. McGraw	Group Vice President
James E. Thompson	Group Vice President, General Counsel and Secretary
Robert F. Reich	Assistant Controller

Parent's Officer and Director are:

Chris A. Davis	Chairman of the Board of Directors
Stanford Springel	Chief Restructuring Officer
Richard J. Buyens	Executive Vice President, Sales
Andreas Papanicolaou	Executive Vice President of Network Services
Patrice M. Carroll	Group Vice President - Business Development
Joseph H. Ceryanec	Group Vice President, Corporate Controller and Treasurer
Gregory S. Crosby	Group Vice President - Marketing
Michael F. Edl	Group Vice President - Network Operations
Roy C. McGraw	Group Vice President - Material Management
J. Christopher Ryan	Group Vice President - Service Delivery
James E. Thompson	Group Vice President, General Counsel and Secretary
Todd W. Wilkens	Group Vice President - Network Engineering
Kurt O. Langel	Vice President - Human Resources

2. *The business purposes for establishing or reorganizing the holding company;*

As set forth above, the purpose of the Plan is to eliminate debt and to allow McLeodUSA to improve its financial strength.

3. *The proposed method of financing the holding company and the resultant capital structure;*

A discussion of the financing and capital structure is contained in Section III above.

4. *The resultant effect on the capital structure of the public utility;*

A discussion of the effect on the capital structure of McLeodUSA is contained in Section III above.

5. *An organization chart of the holding company that identifies all affiliates and their relationships within the holding company;*

See Exhibit A.

6. *The proposed method for allocating federal and state income taxes to the subsidiaries of the holding company;*

The Plan will not have any impact on the present methods for allocating federal and state taxes to the Parent's subsidiaries.

7. *The anticipated changes in the utility's cost of service and the cost of capital attributable to the reorganization;*

The proposed transaction is not expected to impact the regulated company's cost of capital. The Plan will not affect McLeodUSA's rates in Arizona or cause McLeodUSA's maximum rates to increase

8. *A description of diversification plans of affiliates of the holding company;*

There will be no change in the corporate organizational structure as a result of the Plan and no plans for diversification by affiliates of Parent or McLeodUSA.

9. *Copies of all relevant documents and filings with the United States Securities and Exchange Commission and other federal or state agencies.*

A copy of the Plan and other pertinent filings will be submitted to Commission Staff.

10. *The contemplated annual and cumulative investment in each affiliate for the next five years, in dollars and as a percentage of projected net utility plant, and an explanation of the reasons supporting the level of investment and the reasons this level will not increase the risks of investment in the public utility.*

The Plan will provide Parent with improved ability to invest in McLeodUSA.

11. *An explanation of the manner in which the utility can assure that adequate capital will be available for the construction of necessary new utility plant and for improvements in existing utility plant at no greater cost than if the utility or its affiliate did not organize or reorganize a public utility holding company.*

McLeodUSA operates in an extremely competitive environment. The Plan will improve McLeodUSA's ability to compete through improved access to capital and elimination of debt.

V. Rule 804 Analysis.

The Commission's Public Utility Holding Company and Affiliated Interest Rules require approval when a utility subject to the Rules guarantees the debt of an affiliate. A.A.C. R14-2-804 (Rule 804). The Commission will approve a guarantee under Rule 804 unless the guarantee will: (1) "impair the financial status of the public utility"; (2) "otherwise prevent it from attracting capital at fair and reasonable terms"; or (3) "impair the ability of the public utility to provide safe, reasonable and adequate service." A.A.C. R14-2-804.C. As shown in Section III

above, the Restructuring satisfies these tests. A brief point-by-point explanation of how the Rule 804 tests are satisfied follows:

1. *Impair the financial status of the public utility.*

The Restructuring will improve the financial status of the Parties by reducing the Parties' debt. The utility's financial status will thus be bettered, not impaired.

2. *Otherwise prevent it from attracting capital at fair and reasonable terms.*

By improving the Parties' financial status, the Restructuring will likely enable McLeodUSA to better attract capital.

3. *Impair the ability of the public utility to provide safe, reasonable and adequate service.*

The Restructuring will be completely transparent to McLeodUSA's customers, and McLeodUSA will continue to provide the same safe, reasonable and adequate service that it has always provided.

VI. Public Interest Considerations

McLeodUSA respectfully submits that the proposed Restructuring serves the public interest. In particular, McLeodUSA submits that: (1) the Restructuring will increase competition in the Arizona telecommunications market by reinvigorating McLeodUSA as a viable competitor and (2) the Restructuring will preclude any disruption of service that might otherwise result from the Parties' financial condition.

The proposed financial Restructuring is expected to facilitate competition by improving the operational position of McLeodUSA and allowing McLeodUSA to expand its service offerings in the future. The consensual Plan will allow McLeodUSA to maintain its assets while eliminating approximately \$750 million in debt. The Plan also strengthens McLeodUSA by

converting debt secured by McLeodUSA's assets into equity interest in Parent. The company that emerges from Bankruptcy will be much stronger financially with significantly reduced debt. The reinvigoration of McLeodUSA as a viable competitor will thereby significantly enhance competitive choices for telecommunications consumers.

Moreover, given that the Restructuring will not directly affect McLeodUSA's rates, terms and conditions of services, the Restructuring will not negatively impact customers. Indeed, unlike a Chapter 11 reorganization in which a debtor's assets are being sold to a third party, the customers of McLeodUSA will continue to receive service from the same company under the same rates, terms, and conditions of service that those customers currently receive. The Restructuring will therefore be entirely transparent to customers of McLeodUSA. Finally, pursuant to the Plan, no creditor, other than the secured creditors, will be affected by the Restructuring which will ensure uninterrupted operations of McLeodUSA.

VII. Conclusion.

For the reasons stated above, Applicant respectfully submits that the public interest, convenience, and necessity would be furthered granting this Application. Accordingly, Applicant respectfully requests expedited treatment to permit Applicant to consummate the Restructuring on or prior to November 28, 2005 consistent with the anticipated schedule of the Bankruptcy Court.

RESPECTFULLY SUBMITTED this 20th day of October, 2005.

By: 

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Original and 13 copies of the foregoing
filed this 20th day of October 2005 with:

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Arizona Corporation Commission
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Phoenix, Arizona 85007

Copy of the foregoing hand-delivered/mailed
this 20th day of October 2005 to:

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Phoenix, Arizona 85007

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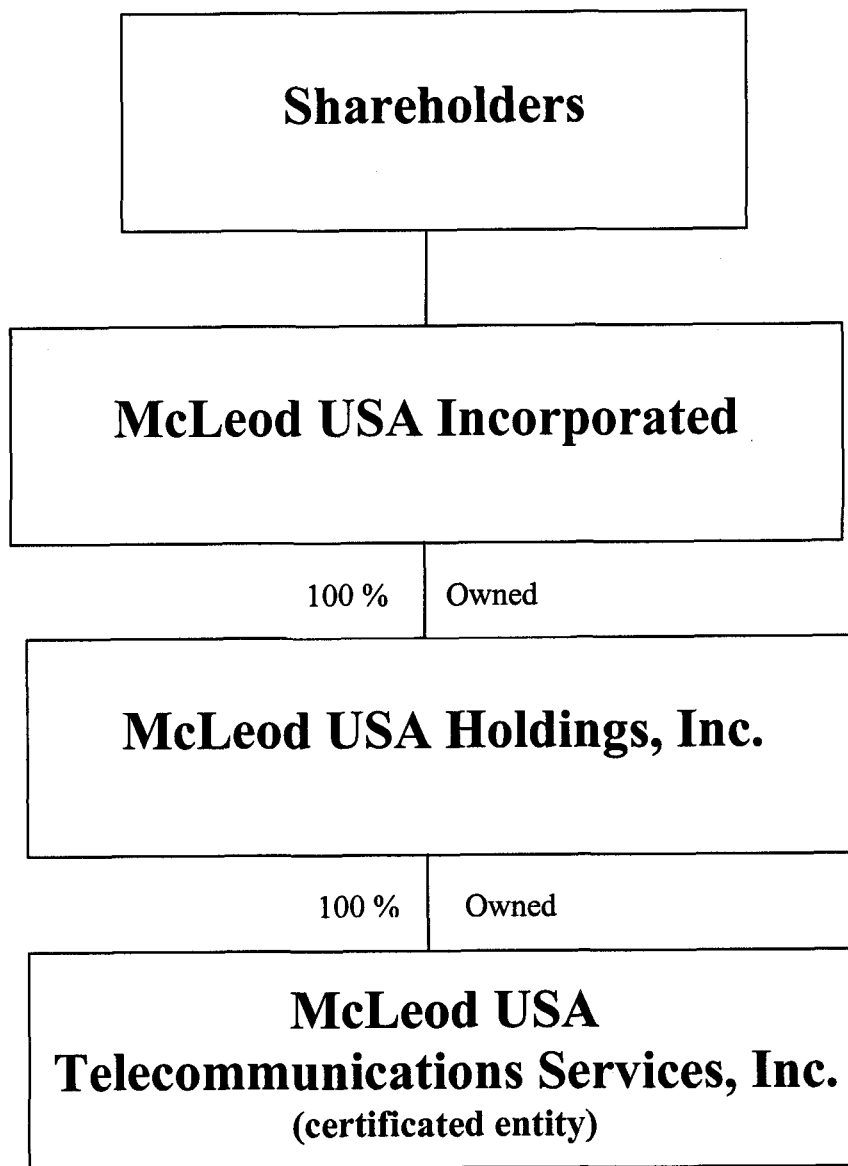
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By Mary J. Sperrito

Exhibit A

Illustrative Organization Chart

Pre and Post Corporate Structure



Verification

VERIFICATION

STATE OF IOWA

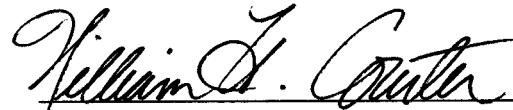
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CITY OF CEDAR RAPIDS

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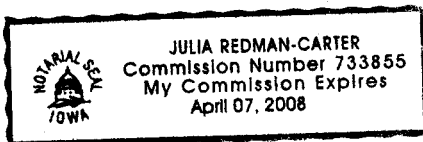
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I, William H. Courter, hereby state that I am Associate General Counsel of McLeodUSA Telecommunications Services, Inc.; that I am authorized to make this Verification on behalf of McLeodUSA Telecommunications Services, Inc.; that the foregoing filing was prepared under my direction and supervision; and that the statements in the foregoing document are true and correct to the best of my knowledge, information, and belief.


William H. Courter
Associate General Counsel

McLeodUSA Telecommunications Services, Inc.

SWORN TO AND SUBSCRIBED before me on the 7 day of October, 2005.




Notary Public

My commission expires: April 7, 2008